

REVIEW OF THE U.S. AGENCY FOR
INTERNATIONAL DEVELOPMENT'S
MANAGEMENT OF THE BASRAH
CHILDREN'S HOSPITAL PROJECT



SIGIR-06-026
JULY 28, 2006



SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

July 28, 2006

MEMORANDUM FOR U.S. AMBASSADOR TO IRAQ
MISSION DIRECTOR-IRAQ, U.S. AGENCY FOR
INTERNATIONAL DEVELOPMENT
DIRECTOR, IRAQ RECONSTRUCTION MANAGEMENT
OFFICE

SUBJECT: Review of the U.S. Agency for International Development's Management of the Basrah Children's Hospital Project (SIGIR-06-026)

We are providing this audit report for your information and use. We performed the audit in accordance with our statutory duties contained in Public Law 108-106, as amended, which requires that we provide for the independent and objective conduct of audits, as well as leadership and coordination of and recommendations on policies designed to promote economy, efficiency, and effectiveness in the administration of Iraq relief and reconstruction programs and operations and to prevent and detect waste, fraud, and abuse.

We considered management comments from the U.S. Mission-Iraq on a draft of this report when preparing the final report. Their comments are addressed in the report where applicable, and a copy of their comments is included in the Management Comments section of this report.

We appreciate the courtesies extended to the staff. For additional information on this report, please contact Mr. Joseph T. McDermott at (703) 343-7926, or by email at joseph.mcdermott@iraq.centcom.mil; or Mr. Clifton Spruill by email at clifton.spruill@iraq.centcom.mil or at (703) 343-9275. For the report distribution, see Appendix C.

A handwritten signature in black ink, reading "Stuart W. Bowen, Jr." with a stylized flourish at the end.

Stuart W. Bowen, Jr.
Inspector General

cc: Distribution

Special Inspector General for Iraq Reconstruction

SIGIR-06-026

July 28, 2006

Review of the U.S. Agency for International Development's Management of the Basrah Children's Hospital Project

Executive Summary

Introduction. As part of the Iraq Relief and Reconstruction Program, the U.S. Agency for International Development (USAID) was tasked with the construction of a modern, 50-bed pediatric facility in Basrah to improve the quality of care and life expectancy for both the women and children of Iraq. In November 2003, Congress authorized \$50 million for this project from the Iraq Relief and Reconstruction Fund (IRRF). USAID, in turn, established a Memorandum of Understanding with Project HOPE, under which Project HOPE would take the lead in providing a significant portion of the hospital equipment and have responsibility for training medical and administrative staff. The scope of work was modified in July 2005 at the request of the Iraqi Ministry of Health to increase the number of beds to 94 and to upgrade the facility to be an oncology center. No additional IRRF funding was requested, nor was the schedule extended as a result of this modification.

USAID issued a job order for construction of the hospital in August 2004 to Bechtel National, Inc. (Bechtel). Bechtel began initial activities to include site preparation and, in mid-October 2004, awarded a design-build subcontract for \$37 million. The job order with Bechtel required that the hospital be completed by December 31, 2005. Completion of the project slipped several times over the next year. The purpose of this review was to determine the effectiveness of the U.S. government project management team and the contracting team in the performance of this project.

Objectives. This review was announced on April 12, 2006, with the objective of assessing the Iraq Reconstruction Management Office's (IRMO) and USAID's management of the Basrah Children's Hospital project. The objectives of the audit were to determine whether:

- USAID has effective policies, procedures, and management controls in place to achieve expected project outcomes
- USAID has adequate financial controls in place to effectively monitor the project and to collect and report on cost to complete
- USAID and IRMO have effective management reporting processes in place to ensure effective transparency of project cost, schedule, and performance

On March 26, 2006, Bechtel reported to USAID that the estimated completion date had slipped to July 31, 2007, and that the estimated cost-at-completion had grown to approximately \$98 million because of project delays and a revision in the allocation of indirect costs. We learned of this project status after our review began, and consequently modified our objectives to determine the reasons for the project slippage and increased costs. Therefore, our review was adjusted to answer the following questions:

- Does USAID have effective processes in place for tracking and reporting the schedules of its Basrah Children's Hospital project?
- Does USAID have effective processes in place for tracking and reporting the cost of the Basrah Children's Hospital project to the Congress and to the Chief of Mission?
- Do USAID and IRMO have effective policies, procedures, and management controls in place to achieve expected project outcomes?

Results. The project status reports received by USAID from its dedicated U.S. Army Corps of Engineers on-site engineer and Bechtel, its prime contractor, regularly identified slippages in the Basrah Children's Hospital project. However, this information was not effectively analyzed or included in Section 2207 Reports or Project Assessment Reports.¹ Specifically,

- Because of subcontractor performance concerns, Bechtel announced in October 2005 that it was conducting a special assessment of the project schedule.
- In late December 2005, the Corps on-site engineer reported the project as 111 days behind schedule and the prime contractor was reporting a delay of 45 days. However, USAID reported no delays with the project in either their January 2006 Section 2207 Report or Project Assessment Report.
- Between January 2 and March 22, 2006, Bechtel reported schedule impacts ranging from 25 days to 77 days. The number of delay days fluctuated as Bechtel worked with the subcontractor to establish recovery plans.
- In March 2006, the Gulf Region Division, U.S. Army Corps of Engineers conducted a "no-notice assessment" of the Basrah Children's Hospital. On approximately March 14, 2006, they estimated a completion date of June 2007.
- On March 26, 2006, Bechtel released its special assessment describing the project as 273 days behind schedule, a slip of 197 days from the delay noted in its report of March 22, 2006.
- In March 2006, the USAID on-site manager reported schedule concerns. Nonetheless, in the April 2006 Section 2207 Report, USAID reported no problems with the project schedule.
- Two weeks later in its April 2006 Project Assessment Report, USAID finally reported the project as delayed by 273 days, with an estimated completion date of July 31, 2007.

¹ Section 2207 of Public Law 108-106 requires a quarterly report to the House and Senate Committees on Appropriations on the use of all IRRF funds on a project-by-project basis. The required information is included in a Section 2207 Report and an accompanying Project Assessment Report.

According to a USAID contracting official, the delays, which included subcontractor design flaws, lack of subcontractor focus on critical path activities, and security concerns, were not reported because the contractor had produced several recovery plans; consequently USAID believed the estimated completion date could still be met. However, according to USAID documents, by December 2005 the contractor had issued three recovery plans, none of which succeeded in recovering the lost time. Yet USAID did not report any concerns as the project continued to fall behind schedule.

Although USAID is responsible for construction of the hospital, it has not included the installation of medical equipment in its estimated project completion schedule or costs. According to a Project HOPE official, the final installation of some medical equipment will not start until construction is completed and will further delay the commissioning of the hospital. According to the USAID Mission Director-Iraq, she did not believe USAID was required to track or report on the medical equipment. Project HOPE is to provide approximately \$30 million in equipment and training, and as of June 25, 2006, reported that it was prepared to meet all commitments for equipment, on time and with the quality and quantity required to support a state-of-the-art tertiary care pediatric center. USAID is responsible for keeping the Congress and the Chief of Mission accurately apprised of the hospital's status. According to the Deputy Chief of Mission, he was unaware that the USAID reported completion date did not reflect delivery of a turnkey operation that would include medical equipment.

USAID's accounting systems and processes are inadequate and failed to accurately identify and report hospital project costs to the Chief of Mission and to the Congress. As of the April 2006 Section 2207 Report to the Congress, USAID reported the hospital project cost-at-completion as \$50 million, even though Bechtel had determined the estimated cost would be at least \$98 million. USAID reported the lower number because it believed that it did not have to include an estimated \$48 million in contractor indirect costs in its reports. While we did not audit USAID's financial records, we believe that it is possible that other cost elements have not been reported which could drive the costs higher. These elements include an appropriate share of the cost of the Participating Agency Service Agreement, established in May 2003 between USAID and the U.S. Army Corps of Engineers.

Based on cost data we obtained from USAID, we believe that, under the current management/contracting structure, the actual turnkey cost for the project will be about \$149.5 million to \$169.5 million including costs for medical equipment, integrating the equipment into the hospital, training of hospital staff and administration, initial sustainment funding, and initial acquisition of consumable medical supplies. A June 2006 USAID contracted study explored other future management/contracting options that have the potential to reduce costs. We also believe that exploring alternative contracting methods could reduce costs.

We also believe that the project will require between \$69.5 million to \$89.5 million of additional funds to complete. This estimate is based on our estimated cost-to-complete of between \$149.5 million to \$169.5 million, minus the \$50 million IRRF allocation and \$30 million from Project HOPE. However, we also caution there is still an unclear picture of schedule control, security, construction quality, and the use of alternative contract/management options that will impact the true cost to complete.

Oversight and management of the Basrah Children's Hospital project schedule and cost has been hampered by the lack of effective program management and oversight by the Department of State and USAID. The Chief of Mission is responsible for the supervision and direction of all U.S. assistance programs, but did not establish a management

structure for carrying out that responsibility. USAID similarly did not establish an appropriate program management structure. Specifically, to oversee its entire \$1.4 billion IRRF construction program which consists of approximately 20 projects across 8 sectors,² USAID relied upon one administrative contracting officer and one cognizant technical officer, and never appointed a program manager with sole responsibility for the hospital project or established a hospital program management office.

Management Actions. In May and June 2006, the Deputy Chief of Mission and the IRMO Director took a number of actions to get control of the contract. On May 19, 2006, the Acting IRMO Director instructed USAID to issue a “stop work” order to its contractor. On June 6, 2006, the Deputy Chief of Mission directed USAID and IRMO to provide specific information on (1) the true cost and schedule to complete the project (the Deputy Chief of Mission defined completion as a fully functioning hospital); (2) what would be accomplished with the \$50 million that was allocated when the costs against this \$50 million would be fully incurred; and (3) what options are available to complete the project to include options for funding, contracting, project management, and oversight. On June 14, 2006, the IRMO Director again instructed USAID to “issue an order to Bechtel National, Inc. to immediately cease construction work other than that necessary to place the site in caretaker status, and to begin demobilization from the job site.”

Recommendations

We recommend that the U.S. Ambassador to Iraq take the following actions:

1. Direct USAID Mission Director-Iraq to:
 - a. Issue a “stop work” order to Bechtel and its subcontractors until there are sufficient plans, resources, and processes in place to ensure a successful project.
 - b. Report on the total project, including Project HOPE’s activities in its Section 2207 Report.
 - c. Provide the IRMO Director with timely, accurate, and complete information as deemed necessary to ensure the project has independent oversight.
2. Direct the IRMO Director and the USAID Mission Director-Iraq to:
 - a. Promptly report on the answers to the Deputy Chief of Mission’s questions provided on June 6, 2006.
 - b. Consider alternative forms of contracting and project management to complete the project.
 - c. Develop a management structure to ensure the success of this project.

SIGIR plans to conduct a review of USAID’s overall Bechtel contract and all USAID-managed IRRF projects to determine if similar reporting has occurred.

² USAID Cost-to-Complete report, May 15, 2006.

Management Comments and Audit Response. We received a consolidated response from the U.S. Mission-Iraq on a draft of this report. The Mission concurred with all of our recommendations and reported that the Ambassador has created and chairs a Reconstruction Core Group which includes all U.S. Mission agencies involved in reconstruction. The Reconstruction Core Group has devised a plan to complete the project in which program and project management for the Basrah Children's Hospital is transferred from USAID to the U.S. Army Corps of Engineers, Gulf Region Division-Project and Contracting Office. The Gulf Region Division plans to establish a Gulf Region Division-led special project office in Basrah with USAID and Project HOPE representatives; a Gulf Region Division-provided hospital and equipment integrator to ensure synchronization of effort; and program management additions at Gulf Region Division Headquarters to ensure adequate controls during execution. We consider this action and other planned actions to be fully responsive to our report.

Table of Contents

| | |
|--|----|
| Executive Summary | i |
| Introduction | |
| Background | 1 |
| Objective | 3 |
| Findings | |
| USAID’s Processes for Tracking, Analyzing and Reporting Project Schedule | 4 |
| USAID’s Accounting Systems and Processes for Identifying Project Costs | 9 |
| USAID and Department of State Management Controls | 14 |
| Conclusion and Recommendations | 17 |
| Appendices | |
| A. Scope and Methodology | 19 |
| B. Acronyms | 21 |
| C. Report Distribution | 22 |
| D. Audit Team Members | 24 |
| Management Comments | |
| U.S. Mission-Iraq | 25 |

Introduction

As part of the Iraq Relief and Reconstruction Program, the U.S. Agency for International Development (USAID) was tasked with the construction of a modern, 50-bed pediatric facility in Basrah to improve the quality of care and life expectancy for both the women and children of Iraq. Congress authorized \$50 million for this project. USAID, in turn, established a Memorandum of Understanding with Project HOPE,³ under which Project HOPE would take the lead in providing a significant portion of the hospital equipment and have responsibility for training medical and administrative staff. As originally scoped, the hospital included inpatient and outpatient specialized pediatric care facilities. The Iraqi Ministry of Health initially requested a 50 bed hospital that would provide referral level pediatric care, with an emphasis on pediatric oncology. The initial design presented to the Ministry of Health included over 25,000 square meters of space with over 100 beds. Subsequent design modifications resulted in the current design, which includes a 94 bed facility and oncology services and radio therapy facilities. No additional funding was requested, nor was the schedule extended as a result of this modification.

USAID issued a job order for construction of the hospital in August 2004 to Bechtel National, Inc. (Bechtel). Bechtel began design-build activities to include site preparation and, in March 2005, awarded a construction subcontract for \$37 million. The hospital was to be completed by December 31, 2005. Completion of the project slipped several times over the next year. The purpose of this review was to determine the effectiveness of the U.S. government project management team and the contracting team in the performance of this project.

Background

In November, 2003, Congress appropriated \$18.4 billion for relief and reconstruction activities in Iraq and allocated the funds to specific sectors of Iraqi infrastructure and governance based on lists of project plans developed over the summer of 2003.⁴ The appropriated money is known as the Iraq Relief and Reconstruction Fund II (IRRF II).⁵ One of the specific projects was the construction of a new, modern, 50-bed pediatric facility in Basrah. This was later changed to a 94 bed facility by a job order amendment. Congress authorized \$50 million for this project. The Coalition Provisional Authority, the U.N. recognized coalition authority led by the United States and the United Kingdom that was responsible for the temporary governance of Iraq and for overseeing, directing, and coordinating the reconstruction effort, assigned responsibility for the project to the United States Agency for International Development (USAID). USAID, in turn, established a Memorandum of Understanding with Project HOPE, a charitable

³ Project HOPE (Health Opportunities for People Everywhere) was founded in the U.S. in 1958. Their mission is to achieve sustainable advances in health care around the world by implementing health education programs and providing humanitarian assistance in areas of need. www.projecthope.org

⁴ House of Representatives Conference Report 108-337, October 30, 2003, "Making Emergency Supplemental Appropriations for Defense and for the Reconstruction of Iraq and Afghanistan for the Fiscal Year Ending September 30, 2004, and For Other Purposes," identifies the programs and the amount authorized for each program.

⁵ Initially Congress appropriated \$2.1 billion to a fund that came to be known as Iraq Relief and Reconstruction Fund I (IRRF I); in November 2003 a second appropriation of \$18.4 billion was made, hence IRRF II.

organization, under which Project HOPE would take the lead in providing hospital equipment and training.

In total, USAID was responsible for \$1.4 billion in IRRF II-funded projects for water and sewer improvement, electrical generation and distribution, and similar construction activities. USAID selected Bechtel National, Inc. (Bechtel) as its prime contractor for all of its projects, and awarded it a cost-plus-fixed-fee design-build contract on January 5, 2004.

On August 3, 2004, Job Order 04-511 for \$50 million for the Basrah Children's Hospital project was issued. In mid-October 2004, Bechtel subcontracted with Midcon/Universal Hospital Services/Hospital Designers and Planners, a Jordanian company, for the hospital development. The original contracted completion date for the hospital was December 31, 2005. However, the hospital project's estimated completion date slipped at least six times between the start of construction in October 2004 and April 2006. The latest estimate for completion is July 31, 2007. Table 1 identifies key events in the chronology of the Basrah Children's Hospital project.

Table 1: Chronology of Basrah Children's Hospital Project

| Date | Project Event |
|-------------------|--|
| August 3, 2004 | Job Order 04-511 issued to Bechtel for construction of the Basrah Children's Hospital. Site preparation and design-build drawings commenced. |
| mid-October 2004 | Bechtel subcontracts for the hospital development. |
| March 1, 2005 | Bechtel mobilizes the subcontractor. Estimated completion date of the hospital construction is December 31, 2005. |
| March 25, 2005 | Bechtel reports a \$6 million increase in direct costs. Project funding remains at \$50 million, with \$7 million to cover indirect costs. |
| April 2005 | USAID reports the estimated completion date has slipped to May 31, 2006. |
| July 2005 | USAID reports the estimated completion date has slipped to September 2006. |
| July 7, 2005 | Job Order Amendment 1 changes completion date to October 31, 2006. |
| October 2005 | USAID reports the estimated completion date has slipped to October 31, 2006. |
| December 28, 2005 | First disbursements reported on hospital construction project |
| March 29, 2006 | Bechtel reports 273-day schedule slip to USAID. Completion date identified as July 31, 2007, with an estimated cost of \$98 million. |
| April 6, 2006 | USAID issues memo to Ambassador Khalilzad citing schedule and cost issues with Bechtel; provides Estimate-at-Complete of \$75 million to \$80 million. |
| May 19, 2006 | IRMO Director issues letter to USAID to "stop work." |
| May 29, 2006 | USAID issues letter to Bechtel to develop a plan to preserve and protect construction work; provide for site security; and demobilize. |
| June 14, 2006 | IRMO Director issues second letter to USAID to "stop work." |

Source: SIGIR analysis of USAID data.

Objectives

This review was announced on April 12, 2006, with the objective of assessing USAID's management of the Basrah Children's Hospital, one of its Iraq reconstruction projects. The objectives of the audit were to determine whether (1) USAID has effective policies, procedures, and management controls in place to achieve expected project outcomes; (2) USAID has adequate financial controls in place to effectively monitor the project and to collect and report on cost to complete; and (3) USAID and the Iraq Reconstruction Management Office (IRMO) have effective management reporting processes in place to ensure effective transparency of project cost, schedule and performance. Upon initiation of the review, we found that on March 26, 2006, Bechtel had informed USAID that the estimated completion date had slipped to July 31, 2007, and the estimated cost-at-completion would be approximately \$98 million. Consequently, we modified our objectives to determine the reasons for the project slippage and why USAID's reports to the Congress and to the Chief of Mission failed to disclose the problems. This review looked specifically at the following:

- Does USAID have effective processes in place for tracking and reporting the schedules of the Basrah Children's Hospital project?
- Does USAID have effective processes in place for tracking and reporting the cost of the Basrah Children's Hospital project to the Congress and to the Chief of Mission?
- Do USAID and IRMO have effective policies, procedures, and management controls in place to achieve expected project outcomes?

In March 2006, the Gulf Region Division, U.S. Army Corps of Engineers conducted a "no-notice assessment" of the Basrah Children's Hospital. This report also presents information from that assessment that may have an additional impact on the project.

For a discussion of the scope, methodology, and a summary of prior coverage, see Appendix A. For definitions of the acronyms used in this report, see Appendix B. For a list of the report distribution, see Appendix C. For a list of the audit team members, see Appendix D.

USAID's Processes for Tracking, Analyzing and Reporting Project Schedule

USAID had good processes in place for tracking the Basrah Children's Hospital project schedule. However, the information it received was not adequately analyzed and passed on to either the Chief of Mission or the Congress in required reports. We recognize that estimating project schedules can be imprecise, particularly in a difficult environment such as Iraq. However, we believe the information available gave USAID ample notice that this project was in trouble.

USAID was responsible for construction of the hospital building, but had not included the installation of medical equipment in its project completion estimate. According to a Project HOPE official, the final installation of some medical equipment will not start until construction is completed and will further delay the commissioning of the hospital. According to the Deputy Chief of Mission, he was unaware that the USAID reported completion date did not reflect delivery of a turnkey operation that would include medical equipment.

Requirement to Report Schedule. The requirement to report project schedule information is found in Public Law 108-106. The Law established the Iraq Relief and Reconstruction Fund and directed the Office of Management and Budget, in consultation with the Department of State, to submit a quarterly report to the House and Senate Committees on Appropriations on the proposed use of all funds including estimates of the costs required to complete each project.⁶ The baseline for reporting (and the identification of the specific projects that the implementing agencies are to report against) is found in the Conference Report that accompanies the Act.⁷ While reporting schedule data is not specified in the law, construction costs are driven in large part by schedule. Consequently, any significant delay in schedule would increase cost and be a reportable event. Additionally, to comply with the law's requirement to provide cost-to-complete data, a combined Office of Management and Budget, Department of Defense, and Department of State team came to Iraq in the spring of 2005 to develop a reporting format. The team developed a format, known as the Project Assessment Report, in which specific financial data on each project are to be reported. One of the reporting elements is the estimated completion date. The Project Assessment Report is submitted to the Congress each quarter on the same schedule as the Section 2207 Report.

Reports to USAID on the Status of the Basrah Children's Hospital. We identified two sets of reports that USAID received weekly on the status of its projects: the reports from the on-site engineer from the U.S. Army Corps of Engineers, and reports from USAID's prime contractor, Bechtel. On May 25, 2003, USAID and the U.S. Army Corps of Engineers signed a Participating Agency Service Agreement to have the Corps of Engineers provide construction oversight of USAID's construction projects. The Corps of Engineers agreed to provide technical assistance to USAID and to be responsible for

⁶ The law assigns the responsibility to the Office of Management and Budget, in consultation with the Coalition Provisional Authority. However, on May 11, 2004, National Security Presidential Directive 36 terminated the Coalition Provisional Authority and assigned all of its responsibilities to the U.S. Mission in Baghdad. IRMO gathers the necessary data from the IRRF-implementing agencies and forwards it to Department of State headquarters, where the report is finalized.

⁷ House of Representatives Conference Report 108-337; Making Emergency Supplemental Appropriations for Defense and for the Reconstruction of Iraq and Afghanistan for the Fiscal Year Ending September 30, 2004, and For Other Purposes, Oct. 30, 2003.

monitoring the quality control, quality assurance, schedule, performance monitoring, safety, environmental issues, de-mining, unexploded ordinance, and safety programs of Bechtel, and report to the USAID contracting officer and cognizant technical officer when exceptions or problems were uncovered. Pursuant to this agreement, the Corps of Engineers had an engineer on-site at the hospital project starting in December 2004, and the engineer submitted weekly status reports to USAID on the Basrah Hospital project. On about December 20, 2005, the Corps' engineer departed and was replaced by a USAID representative who continued with the weekly Project Review Reports.

The second set of reports was provided by the contractor. Under the terms of the contract, Bechtel reported and met weekly with USAID on the status of projects. USAID received a number of recurring reports from Bechtel including Weekly Project Review reports, Trend reports, and Critical Action Item reports.

Information Available to USAID on the Status of the Hospital Project. The following shows the information reported to USAID by its on-site engineer and its contractor. As discussed, the original contracted completion date for the hospital was December 31, 2005.

January to March 2005

During this quarter, the project completion date slipped from December 31, 2005, to May 31, 2006. Between January and April 2005, the Corps' on-site engineer reported a steady slippage in the estimated completion date of the contract because of delays by the Iraqi Ministry of Health in making facility design requirement decisions. According to the reports, this added about 90 days to the schedule. Site security was also cited as a concern, and the engineer alerted USAID that the schedule for laying pilings could add up to 50 days to the schedule.⁸ By the end of the quarter, the Corps' on-site engineer was estimating the completion date as May 31, 2006. The schedule slippage was also reported by the contractor, along with concerns about overall project cost.

In the April 2005 Section 2207 Report to the Congress USAID identified the estimated completion date as March 30, 2006. At this time, USAID was not preparing Project Assessment Reports and was not reporting an estimated cost at completion.

April to June 2005

Between April and June 2005, the estimated completion date slipped from May 31, 2006, to September 15, 2006. The Corps' on-site engineer reported the slippages created by facility design decision delays and site security throughout the quarter and also reported that the design-build estimate received exceeded the job order budget, and that the budget and site security were concerns.

The contractor, Bechtel, was also reporting that forecasted costs would exceed budget and that the forecast completion would be September 15, 2006. An amendment to the job order was initiated to address the cost issue.

In the July 2005 Section 2207 Report to the Congress, USAID identified the estimated completion date as September 2006. USAID was still not preparing Project Assessment Reports at this time and was not reporting an estimated cost at completion.

⁸ Pilings are concrete rods driven into the earth upon which the hospital foundation rests.

July to September 2005

On July 7, 2005, amendment 1 to the job order was signed by USAID and Bechtel, extending the estimated completion date to October 31, 2006, and increasing the direct costs of the subcontractor for constructing the hospital from \$37 million to \$41 million. This addressed the cost issues identified in the previous quarter. Starting in the July 22, 2006 report, the Corps' on-site engineer reported the same estimated project completion date of October 31, 2006; which corresponded with amendment 1 for the end of the Bechtel contract, so it would not have been possible to go past that point without a contract extension. Instead of changing the estimated completion date, however, the engineer started identifying construction delays in the narrative section of the report. By August, the on-site engineer was reporting that the October 31, 2006, completion date was at risk because of problems with the pilings. The amount of delay gradually increased, until by late-September he was identifying the project as 51 days behind schedule. He also reported that Bechtel and the sub-contractor had implemented a work plan to put the project back on schedule.

Neither USAID nor Bechtel reported any problems with the contract throughout this period. The October 2005 Section 2207 Report did not identify the on-site engineer's concerns with the project and no mention was made of the 51-day potential delay. The first Project Assessment Report was issued in October 2005, for the period ending September 30, 2005, and reported the estimated completion date as October 31, 2006, and the estimated cost at completion as \$50 million, despite the 10 month slip in the schedule from the original December 31, 2005 completion date.

October to December 2005

From October to December 2005, the Corps' on-site engineer continued to identify the completion date as October 31, 2006, but in his narrative identified a steady slip in the project schedule. Bechtel was operating from a revised schedule based on the previous quarter's 51-day slip. Beginning from the first report of the quarter the on-site engineer reported a growing deviation from the revised schedule. By December 12, 2005, the on-site engineer was reporting the contractor as 8 weeks behind its revised schedule. On December 18, 2005, the Corps' on-site engineer submitted a special baseline schedule assessment, which stated that the project was 111 days behind schedule due to errors in construction documents, lack of subcontractor focus on critical path activities, and slowdown in construction in order to ensure quality output. The on-site engineer also reported pessimism about recovery. According to the assessment, "(t)he project is on its third recovery plan to reduce the project schedule deficit. The third recovery plan indicates that it will eliminate approximately 80 days of the project schedule deficit. None of the previous recovery plans have worked to date as the project continues to fall further behind."

In the December 20, 2005, Project Review Report, a USAID on-site representative replaced the departed Corps' engineer and began using a new methodology for reporting the project's status. In reports filed in late-December and early January he continued to identify the specific number of days the project was behind schedule. However, he also started using a color code system to report project status in which he reported the project as "Green, Amber, or Red." For example, in the December 20 report he stated that the project was six weeks behind schedule and that the status of the project was changed from "Green to Amber" because it was falling behind schedule.

Bechtel was also reporting delays but was less pessimistic than the on-site engineer. However, the contractor announced that it was going to do a special assessment of the

project schedule. On October 21, 2005, Bechtel was reporting the estimated completion as 22 days behind schedule and gradually increased that estimate through the quarter until, by December 26, 2005, Bechtel was reporting the project as 44 days late.

The January 2006 Section 2207 Report and Project Assessment Report did not identify any delays on the project. The Project Assessment Report identified the estimated completion date as October 31, 2006, and the estimated cost at completion as \$50 million.

January to March 2006

By mid-January 2006, the USAID representative stopped reporting days behind schedule altogether, and reported project status using the color code only. From January 17 through March 19, 2006, the USAID representative assessed the project as “Amber” in eight consecutive weekly reports, citing schedule concerns. Finally, on April 4, 2006, the USAID representative reported the project as “RED – Behind schedule.”

Bechtel submitted similarly pessimistic reports, identifying the project in its January 2, 2006, report as 25 days behind schedule and increasing that estimate in every weekly report through March 22, 2006, at which time it announced the project as 77 days behind schedule. Finally, on March 26, 2006, Bechtel released its project assessment and briefed USAID that the project was 273 days behind schedule with a new estimated completion date of July 31, 2007. Nonetheless, in the April 2006 Section 2207 Report, USAID reported no problems with the project schedule.

Table 2 shows the information available to USAID and what it reported from January 2005 through April 2006.

Table 2: USAID Reports to the Congress on Status of Basrah Children’s Hospital

| Section 2207 Report Dates to Congress | Corps of Engineers’/USAID On-Site Reports on Project Status | Completion Date Reported to Congress in Section 2207 Report | Completion Date Reported in Project Assessment Reports | Estimated Cost at-Completion in Project Assessment Report |
|--|--|--|---|--|
| January 2005 ¹ | Estimated completion of February 28, 2006 | December 2005 | Report not prepared | Not provided |
| April 2005 | Estimated completion of May 31, 2006 | March 2006 | Report not prepared | Not provided |
| July 2005 | Estimated completion of September 15, 2006 | September 2006 | Report not prepared | Not provided |
| October 2005 | 51 days behind schedule | A project completion date was not identified | October 31, 2006 | \$50,000,000 |
| January 2006 | 111 days behind schedule | A project completion date was not identified | October 31, 2006 | \$50,000,000 |
| April 2006 | Status: Red “Behind Schedule” | A project completion date was not identified | July 31, 2007 | \$61,752,474 |

¹Construction of the hospital began in mid-October 2004.

According to USAID officials, they were aware of the 77 day slip in the January to March 2006 period (due to concrete pouring falling behind schedule, local holidays, and security concerns), but were taken by surprise by the (cumulative) 273 day slip announced by the contractor. Bechtel explained that problems continued between the subcontractor and its sub-tier contractors that resulted in work slowdowns/stoppages. USAID also said that they did not report the delays because with each slip the contractor provided a new schedule identifying how it intended to make up the lost time.

We recognize that estimating project schedules is an imprecise art, particularly in an environment as difficult and challenging as Iraq. Projects can fall behind schedule and a recovery can sometimes occur. However, as stated earlier, by July 2005 the project was already 10 months behind its original schedule and the delays were increasing on a monthly basis. Further, the contractor had submitted numerous recovery plans for the hospital to reduce the project's schedule deficit, none had worked, and the project continued to fall further behind. Given the 15-month long pattern of delays coupled with the contractor's inability to recover from those delays, we believe that USAID had ample information to conclude that the hospital project was in trouble.

Integrating Medical Equipment Will Add To the Delay. USAID was responsible for construction of the hospital building and has not included the installation of medical equipment in its project completion estimate. According to a Project HOPE official, the final installation of some medical equipment will not start until construction is completed and will further delay the commissioning of the hospital. Project HOPE is to provide approximately \$30 million in equipment and training, and as of June 25, 2006, reports that it is prepared to meet all commitments for equipment, on time and with the quality and quantity required to support a state-of-the-art tertiary care pediatric center. According to the USAID Director, USAID was not required to report on the medical equipment and is not required to include Project HOPE's contribution in its Section 2207 Report. While we agree that USAID is not responsible for the equipment, it is responsible for integrating Project HOPE's contribution into its plans. Further, "completion" of a hospital that lacks its operating equipment is not an accurate appraisal of the project's status. For example, the Deputy Chief of Mission was unaware that the completion date did not reflect delivery of a turnkey operation that would include medical equipment.

USAID's Accounting Systems and Processes for Identifying Project Costs

USAID's accounting systems and processes are inadequate and failed to accurately identify and report hospital project costs to the Chief of Mission and to the Congress. As of the April 2006 Section 2207 Report to the Congress, USAID was reporting the hospital project cost as \$50 million, even though the contractor estimated the cost at \$98 million. USAID reported the lower number because it believed that it did not have to include an estimated \$48 million in contractor indirect costs in its reports. According to a USAID contracting officer, USAID did not report these costs so it could stay within the \$50 million authorization. While we did not conduct an audit of USAID's financial records, we observed that other cost elements, such as the costs of the Corps of Engineers' Participating Agency Service Agreement, have not been reported, which could drive the costs higher. USAID also mis-reported its disbursements against the hospital project (and all other projects), further obscuring the status of the project. SIGIR plans to conduct an audit of USAID's overall Bechtel contract and all USAID-managed Iraq Relief and Reconstruction Fund projects to determine if similar reporting has occurred.

USAID's Categorization of Costs for the Hospital Project. Public Law 108-106 established the Iraq Relief and Reconstruction Fund, and allocated \$18.439 billion to specific sectors of Iraq society and governance. The funds were further allocated down to projects within each sector, one of which was the Basrah Children's Hospital project.⁹ In total, \$50 million was authorized for this project. These funds were to finance all expenses of the project, to include the hospital's direct and indirect costs.

USAID contracting documents show that it was aware that the \$50 million authorized for the hospital was to fund all construction costs of the hospital including both the direct and indirect costs. The contract job order defines the scope of work as "the design and construction of a pediatric teaching hospital in the city of Basrah," with an initial rough order of magnitude cost estimate of \$37 million. Bechtel, in turn, awarded a firm-fixed-price subcontract for the \$37 million, and set aside \$13 million to cover indirect costs. USAID reviewed Bechtel's subcontract and agreed with it and the \$13 million indirect cost set aside.

USAID identifies two types of what it refers to as "distributable" indirect costs: indirect costs at the job order level and indirect costs at the contract level. Indirect costs at the job order level consist of items such as the salary of the acquisition team and subcontract management, camps, security, and office equipment. Indirect costs at the contract level consist of such items as the prime contractor's mobilization expenses, the contractor's fixed fee for mobilization, and the contractor's fixed fee for the job orders. During the early implementation of the contract, these "distributable costs" were estimated using a fixed percentage of the job order direct costs; estimated to be 35 percent of the direct costs based on historical information and experience. This methodology was used to estimate "distributable" indirect costs for all USAID job orders until early 2005.

⁹ House of Representatives Conference Report 108-337, October 30, 2003, "Making Emergency Supplemental Appropriations for Defense and for the Reconstruction of Iraq and Afghanistan for the Fiscal Year Ending September 30, 2004, and For Other Purposes," identifies the programs and the amount authorized for each program.

USAID Funding and Indirect Cost Allocation Issues. In November 2004, USAID reduced the estimated cost of its Bechtel contract from \$1.8 billion to \$1.4 billion in response to a reallocation of IRRF funding between sectors directed by the Chief of Mission. However, because USAID had allowed Bechtel to mobilize the staff and resources needed to implement a \$1.8 billion contract, it was now faced with greatly increased mobilization costs and fewer job orders to allocate the costs against.

In March 2005, USAID took its problem to the Iraq Reconstruction Management Office (IRMO) and asked permission to reduce the scope of a number of its projects to resolve its funding problems. Altogether, USAID asked for \$74 million in project cancellations and scope changes. USAID also asked for permission to make \$25.5 million worth of within-scope changes to a number of its projects, including a \$6 million within-scope change to the Basrah Children's Hospital "to absorb greatly increased construction costs." According to the USAID memorandum, "(The costs) (w)ill be offset by reducing contractor overhead allocated to this project." On March 23, 2005, the former IRMO Director gave USAID permission to carry out its plan. This scenario was reflected in a reallocation spreadsheet prepared by USAID on March 23, 2005, which showed a new direct cost threshold of \$43 million and an indirect cost threshold of \$7 million for the Basrah Children's Hospital project.

We were unable to locate any documentation that expands upon the agreement reached between USAID and IRMO. According to the former IRMO Deputy Director for Operations, the memorandum was not intended to give USAID blanket permission to change the reporting of all indirect costs. Rather, it was seen as a one-time solution to resolve USAID's funding problem. An attachment to the agreement indicates that it was reviewed by the IRMO Budget Officer, the IRMO Director of Operations, and a Department of State legal officer. Regardless of the decision made by IRMO, we find the entire agreement unclear. The document states that hospital project cost increases would be offset by reducing contractor overhead allocated to the project, but project reports for the period show no effort to reduce overhead. If the intent was to allow USAID to stop reporting its overhead, as stated by USAID, we again fail to see how this would benefit USAID in its effort to "rebalance" its programs and free up money to alleviate a funding shortfall. Funds would not be freed up by reducing indirect costs. Rather, the hospital project's legitimate indirect costs would have to be assigned to another project creating an additional funding burden for another project.

Beginning in March 2005 through April 2006, USAID started assigning its "distributable" indirect costs solely on the difference between the amount obligated to a sub-sector and the direct costs incurred by the sub-sector. For example, a USAID document dated March 23, 2005, shows the estimated direct cost of the Mussayab Thermal Power Station as \$6.6 million and the indirect cost for the project as \$27.6 million (a 418 percent indirect cost rate). Conversely, the same document shows the estimated cost of the Baghdad South Phase II Electric project as \$164.3 million and the indirect cost as \$1.4 million (a 0.8 percent indirect cost rate). According to a USAID contracting officer, USAID did this to stay within the authorization for each project. Also, USAID's Iraq mission believed that when IRMO gave its permission to reduce the amount of indirect costs that USAID had to apply to the Basrah Children's Hospital project, that USAID also received blanket permission to assign its "distributable" indirect costs in a similar manner for all of its projects for the remainder of the contract period.

USAID's failure to properly report its indirect costs to the appropriate project can also be seen in the cost estimates for the hospital project that it provided to the Congress. The job order for the Basrah Children's Hospital was signed on August 3, 2004, and the completion date was identified as December 31, 2005. That date remained the official

contract completion date until July 7, 2005, when USAID amended the contract and revised the completion date to October 31, 2006. USAID made no other changes in the schedule until April 2006, when it notified IRMO that Bechtel changed the completion date to July 31, 2007. In every Section 2207 Report submitted to the Congress from January 2005 through April 2006 (a total of six reports) USAID identified the hospital project as a \$50 million project, even though the project had slipped by at least 10 months. Bechtel's distributable indirect costs were around \$400,000 per day for all USAID projects, including for this hospital project. Consequently, under normal cost allocation procedures, the 10-month slip in the hospital schedule should have had a significant effect on hospital costs.

The net effect of USAID's accounting errors is that millions of dollars in indirect costs that should have been applied to the hospital project were applied to other USAID projects resulting in a serious misstatement of hospital project costs. While, we did not conduct an audit of USAID's financial records, it is likely, in our view, that the current estimates identified by USAID do not contain all elements of cost that should correctly be assigned to the hospital. For example, we have been unable to determine if the Corps of Engineers' cost for managing USAID projects has been correctly assigned to this project.

USAID's Reporting of Contract Disbursements. The increase in costs that should have been aligned with the hospital project was further obscured by USAID's failure to accurately record or report the hospital project's disbursements. Although the hospital project began in October 2004, USAID did not report any disbursements for the hospital until December 28, 2005 (three days before the original project completion date of December 31, 2005). These disbursements were first identified to Congress in the January 2006, Section 2207 Report. With no disbursements reported, it appeared that the project had not begun, and consequently, project completion delays raised no red flags that problems were being encountered. Comparing disbursements to estimated project costs provides a status of funding available for a project. Instead of reporting disbursements against the appropriate job order, USAID instead arbitrarily assigned them against its oldest obligations. As a result, the actual status of all of its projects was not apparent. USAID is still uncertain about the amount it has disbursed for the Basrah Children's Hospital project. Specifically, in a June 2006 report to the Deputy Chief of Mission, USAID reported disbursements as \$42 million as of May 15, 2006. However, one week later it was reporting its disbursements as \$31 million.

USAID's Compliance to Rules. As discussed earlier, USAID contracting and finance officials told us that they believed that when IRMO gave its permission in March 2005 to reduce the amount of indirect costs that USAID had to apply to the Basrah Children's Hospital, it had also received blanket permission to assign its "distributable" indirect costs in a similar manner for all of its projects in all future reports. They do not perceive that what they did was incorrect because, according to the administrative contracting officer, USAID only has one contract, the umbrella Bechtel contract, and that contract is being managed in accordance with the Federal Acquisition Regulations. The administrative contracting officer said that job orders (such as the one directing the construction of the children's hospital) are not legal documents; rather they are letters or other written communications signed by the contracting officer authorizing the contractor to proceed to implement an identified project. The job order is not an obligating document; it was used to identify the scope and rough order of magnitude for a particular infrastructure project. Therefore, exceeding the cost of a job order is not consequential.

We disagree with USAID's analysis for a number of reasons. Public Law 108-106 directed that the implementing agencies report to Congress on a project-by-project basis. The definition of a project was clearly identified in Congress' authorization of the IRRF

appropriation in which the Basrah Children's Hospital was identified as one project in the Health Sector. Further, the Office of Management and Budget allocated the IRRF money to USAID using Standard Form 132, which further identified the Basrah Children's Hospital as a project. Each quarter USAID submitted its input for the Section 2207 report in which it reported on the Basrah Children's Hospital as a single project. In fact, the requirement in Public Law 108-106 to report costs at a project level is not ambiguous. The law requires the reporting of all funds on a project by project basis along with an estimate of the costs required to complete each project. The costs identified by USAID for the Basrah Children's Hospital did not satisfy either of these requirements.

Estimated Cost at Completion of the Hospital Will Be About \$149.5 Million to \$169.5 Million. Based on cost data we obtained from USAID, we believe that, under the current management/contracting structure, the actual "turnkey" cost for the project will be about \$149.5 million to \$169.5 million, including costs for medical equipment, integrating the equipment into the hospital, training of hospital staff and administration, initial sustainment funding, and initial acquisition of consumable medical supplies. Additionally, further delays in construction and construction deficiencies recently identified by the Gulf Region Division, U.S. Army Corps of Engineers, have the potential to push the costs higher. A June 2006 contracted study by the Louis Berger Group has explored other management/contracting options that have the potential to reduce costs. Our estimate is also intended only to provide a rough estimate of what we believe the costs would be if the status quo is maintained.

Our estimate uses USAID data, that assumes that construction of the hospital will be completed by July 31, 2007, and we added a 10 percent contingency in the event the schedule slips further. Security of the hospital and other indirect costs that will be incurred while medical equipment is being installed after construction is complete will increase the total cost further. Our estimate of \$30 to \$50 million for medical equipment is based on USAID's original estimate and an estimate provided by a USAID contractor. However, we also caution there is still an unclear picture of schedule control, security, construction quality, and the use of alternative contract/management options that will impact the true cost to complete. See Table 3 for our estimate.

Table 3: SIGIR's cost-to-complete estimate for the Basrah Children's Hospital Project

| | |
|--|-------------------------------------|
| Construction Direct Cost (from estimate at completion) | \$ 50.0 million |
| Construction Indirect Costs (USAID estimate) | \$ 48.0 million |
| 10% Contingency for schedule slips | \$ 10.0 million |
| Sustainability-Year 1 (15% of direct and contingency) | \$ 9.0 million |
| Equipment – estimate | \$ 30.0 to \$50.0 million |
| Medical equipment integrator | \$ 1.0 million |
| Consumable medical supplies | \$ 1.5 million |
| Total | \$149.5 to \$169.5.3 million |

Source: SIGIR analysis of USAID data, as of June 26, 2006.

Complicating the estimate is a March 2006 Gulf Region Division, U.S. Army Corps of Engineers assessment of the project that describes the overall quality of work at the project as meeting minimum acceptable limits. The Corps' assessment cites "serious cracks" in the concrete. Repairing these cracks could add to the total construction cost of the hospital. The Corps' report is discussed in more detail later in this report.

In June 2006, USAID contracted with the Louis Berger Group to conduct a Completion Assessment of the Basrah Children's Hospital. The contractor deployed an assessment team to Iraq and on June 27, 2006, submitted its report. The contractor identified five options:

1. Withdrawing from the Basrah Children's Hospital project altogether.
2. Continuing the status quo until the project is finished.
3. Discontinue Bechtel as the prime contractor and assign project responsibility to the Corps of Engineers, Gulf Region Division.
4. Continue to build, but descope the level of clinical services provided to the people of Basrah under this program and yet retain the core focus of oncology services and pediatric surgery.
5. Assign project execution to an Iraqi ministry.

The assessment team concluded that maintaining the status quo would cost approximately \$131 million, not including medical equipment. The recommended option was discontinuing Bechtel as the prime contractor and assigning responsibility to the Corps of Engineers, Gulf Region Division. This option has the potential to reduce costs to approximately \$90 million plus the cost of medical equipment. The savings comes almost exclusively from the reduction in contractor overhead.

USAID and Department of State Management Controls

Oversight and management of the Basrah Children's Hospital project has been hampered by the lack of effective program management and oversight by the Department of State and USAID. The Chief of Mission is responsible for the supervision and direction of all U.S. assistance programs, but did not establish a management structure for carrying out that responsibility. USAID similarly did not establish an appropriate program management structure.

Department of State Oversight of IRRF Projects Needs Improvement.

Responsibility for the supervision and direction of all U.S. assistance activities for Iraq was assigned to the Chief of the U.S. Mission in Iraq by National Presidential Security Directive 36, dated May 11, 2003. The Directive also established a temporary office within the Department of State called the Iraq Reconstruction Management Office, to "facilitate the transition in Iraq." According to an operating structure schematic, the Director of IRMO reports to the U.S. Ambassador, as does the Director of the USAID Mission. The exact authorities and responsibilities of IRMO, however, are not clearly defined. As a result, what has emerged is an unclear and sometimes contentious relationship between IRMO and USAID. During our review, IRMO officials have complained to us about the difficulty in obtaining basic information from USAID on the Basrah hospital project status and funding. This lack of authority makes it exceedingly difficult for IRMO to carry out its mission. We believe that providing IRMO with the authority to request and receive timely, accurate, complete information on IRRF projects would greatly improve the Department of State's oversight, and preclude surprises such as occurred on the Basrah Hospital project.

USAID's Staff Resources to Manage Contracts. USAID is responsible and accountable for the overall implementation of all of its reconstruction activities and for providing technical and management oversight of the work to be performed by Bechtel. To accomplish these responsibilities, USAID and the U.S. Army Corps of Engineers signed a Participating Agency Service Agreement to have the Corps of Engineers provide construction oversight of Bechtel. The Participating Agency Service Agreement has a total estimated cost of \$34.886 million, and when last modified on June 23, 2005, had an obligation level of \$29.244 million. Under the agreement, the Corps of Engineers was to provide technical assistance to USAID and to be responsible for monitoring the quality control, quality assurance, schedule, performance monitoring, safety, environmental issues, de-mining/unexploded ordinance, and safety programs of Bechtel, and report to the USAID contracting officer and cognizant technical officer when exceptions or problems were uncovered. Correspondence amongst USAID officials makes it clear that the Corps of Engineers' charter was technical oversight (not management) of the contract. The Corps provided these functions for USAID through December 2005, at which time the Corp's on-site engineer departed country and was not replaced. Instead, USAID directed that a USAID agent who was also on-site take over some of the responsibilities of the Corps engineer.

While USAID had the agreement with the Corps to provide on-site monitoring, its project management team and contracting team was largely understaffed. The contracting officer appointed one administrative contracting officer in Baghdad to oversee the contract. The administrative contracting officer, in turn, was assisted in Baghdad by one cognizant technical officer. These three individuals were responsible for the contract oversight of the entire \$1.4 billion contract comprised of 20 IRRF-funded construction projects

covering facilities and subprojects located throughout Iraq. They were assisted, since December 2005, by a USAID representative based in Basrah. This individual was not, however, a hospital construction specialist. The team was also assisted by a Senior Contract Specialist, a trainee Contract Specialist, USAID's Sector Managers, and USAID-Iraq Financial Management Office. However, based on the job responsibilities described below, we do not believe that this constitutes sufficient staff to oversee and monitor a construction program of this magnitude.

Some of the responsibilities identified in the umbrella contract with Bechtel that the administrative contracting officer and the cognizant technical officer were expected to accomplish for a \$1.4 billion construction program include the following:

Administrative contracting officer

- Determine the allowability of costs suspended or disapproved, direct the suspension or disapproval of costs when there is reason to believe they should be suspended or disapproved, and approve final vouchers.
- Review and approve or disapprove the contractor's request for payments.
- Ensure timely notification by the contractor of any anticipated overrun or under run of the estimated cost under cost reimbursement contracts.
- Negotiate prices and execute supplemental agreements for spare parts and other items.
- Perform property administration.
- Perform necessary screening, redistribution, and disposal of contractor inventory.
- Ensure contractor compliance with quality assurance requirements.
- Ensure contractor compliance with contractual safety requirements.
- Perform engineering surveillance to assess compliance with contractual terms for schedule, cost, and technical performance in the areas of design, development, and production.

Cognizant technical officer

- Assure that the contractor performs the technical requirements of the contract in accordance with the contract terms, conditions, and specifications.
- Perform, or cause to be performed, inspections necessary (in ensuring the contractor performs the technical requirements of the contract).
- Issue written interpretation of technical requirements of government drawings, designs, and specifications.
- Monitor the contractor's production or performance progress and notify the contractor in writing of deficiencies observed during surveillance, and direct appropriate action to effect correction.

Management Actions

In May and June 2006, the Deputy Chief of Mission and the IRMO Director took a number of actions to get control of the Basrah Children's Hospital project.

- On May 19, 2006, the Acting IRMO Director instructed USAID to issue a "stop work" order to its contractor. According to the Action Memorandum issued to USAID, this action was intended to preserve remaining funds within the \$50 million allocation while the schedule and cost-to-complete were reviewed and appropriate decisions made and implemented. The Acting IRMO Director's instruction was not followed.
- On June 6, 2006, the Deputy Chief of Mission chaired a meeting of senior IRMO staff and the USAID Director. At that meeting, USAID presented a briefing on the status of the Basrah Children's Hospital. At the conclusion of the meeting the Deputy Chief of Mission directed USAID and IRMO to provide specific information on (1) the true cost and schedule to complete the project (the Deputy Chief of Mission defined completion as a fully functioning hospital); (2) what would be accomplished with the \$50 million that was allocated and when the costs against this \$50 million would be fully incurred; and (3) what options are available to complete the project to include options for funding, contracting, project management, and oversight.
- On June 14, 2006, the IRMO Director again instructed USAID to "issue an order to Bechtel National, Inc. to immediately cease construction work other than that necessary to place the site in caretaker status, and to begin demobilization from the job site." The letter also stated, "(A)dditionally, USAID is instructed that remaining funds shall be used to (sic) for physical security of the job site and to secure the work to date for a period of no less than 120-days."

Conclusion and Recommendations

Conclusion

Construction of the Basrah Children's Hospital project began in October 2004 with an estimated completion date of December 2005 and by July 2005 the schedule had slipped 10 months to October 2006. Despite schedule revisions and other efforts to catch up, the project remained behind schedule. Starting in October 2005 the schedule slippage began to accelerate and by December the Corps' on-site engineer was reporting the project as 111 days past the October 2006 completion date. Finally, on March 26, 2006, Bechtel revised the estimated completion date to July 31, 2007. Despite regular alerts from several sources, little of this information was reported by USAID in the Section 2207 Reports to the Congress or into USAID'S Project Assessment Reports.

A similar situation exists with costs. From at least March 2005 USAID has known that the hospital would not be built within the \$50 million congressional authorization. However, in all reports submitted to Congress between March 2005 and March 2006, USAID continued to describe the hospital as a \$50-million project. To stay within that cost limit, USAID stopped reporting the indirect costs that should have correctly been assigned. These costs estimates were significant, conceivably totaling \$48 million at completion. According to USAID officials, they believed they had the permission of IRMO to report in this manner. Regardless of any permission that may or may not have been given by IRMO, however, arbitrarily assigning costs does not meet the requirement in Public Law 108-106 to report costs on a project-by-project basis along with a cost-to-complete estimate for each project.

The lack of effective program management and oversight by the Department of State and USAID contributed significantly to the Basrah Children's Hospital project problems. The Iraq Chief of Mission is responsible for the supervision and direction of Iraq assistance programs but has never established an oversight process that meets either requirement. Project management has been left primarily in the hands of the implementing agencies, with little oversight or direction from the Department of State. USAID also has not established an effective project management structure. Currently one contracting officer, one administrative contracting officer, and one cognizant technical officer; along with a handful of program staff, are responsible for the management and oversight of approximately \$1.4 billion in construction activities, and no hospital project management office has been established.

We also believe that the project will require between \$69.5 million to \$89.5 million of additional funds to complete. This estimate is based on our estimated cost-to-complete of between \$149.5 million to \$169.5 million, minus the \$50 million IRRF allocation and \$30 million from Project HOPE. However, we also caution there is still an unclear picture of schedule control, security, construction quality, and the use of alternative contract/management options that will impact the true cost to complete.

Recommendations

We recommend that the U.S. Ambassador to Iraq take the following actions:

1. Direct USAID Mission Director-Iraq to:
 - a. Issue a “stop work” order to Bechtel and its subcontractors until there are sufficient plans, resources, and processes in place to ensure a successful project.
 - b. Report on the total project, including Project HOPE’s activities in its Section 2207 Report.
 - c. Provide the IRMO Director with timely, accurate, and complete information as deemed necessary to ensure the project has independent oversight.
2. Direct the IRMO Director and the USAID Mission Director-Iraq to:
 - a. Promptly report on the answers to the Deputy Chief of Mission’s questions provided on June 6, 2006.
 - b. Consider alternative forms of contracting and project management to complete the project.
 - c. Develop a management structure to ensure the success of this project.

SIGIR plans to conduct a review of USAID’s overall Bechtel contract and all USAID-managed IRRF projects to determine if similar reporting has occurred.

Management Comments and Audit Response

We received a consolidated response from the U.S. Mission-Iraq on a draft of this report. The Mission concurred with all of our recommendations and identified a number of actions underway. Foremost, the Ambassador has created and chairs a Reconstruction Core Group which includes all U.S. Mission agencies involved in reconstruction. The Reconstruction Core Group has devised a plan to complete the project in which program and project management for the Basrah Children’s Hospital is transferred from USAID to the U.S. Army Corps of Engineers, Gulf Region Division- Project and Contracting Office. The Gulf Region Division plans to establish a Gulf Region Division-led special project office in Basrah with USAID and Project HOPE representatives, a Gulf Region Division provided hospital and equipment integrator to ensure synchronization of effort, and program management additions at Gulf Region Division Headquarters to ensure adequate controls during execution. The Ambassador has also:

- issued an instruction to all agencies that implement U.S. assistance under his authority to provide the Iraq Reconstruction Management Office with accurate and complete information on projects
- directed the USAID Director to work with the IRMO Director to establish reporting systems that assure that information is made available that reflects the most accurate possible direct and indirect cost allocations by projects and programs.

We consider these actions and other planned U.S. Mission actions to be fully responsive to our report.

Appendix A. Scope and Methodology

This review was announced on April 12, 2006 (Project No. 6016), with the objective of assessing the Iraq Reconstruction Management Office's (IRMO) and USAID's management of the Basrah Children's Hospital project. The announced objectives of the audit were to determine (1) whether USAID has effective policies, procedures, and management controls in place to achieve expected project outcomes; (2) whether USAID has adequate financial controls in place to effectively monitor the project and to collect and report on cost to complete; and (3) whether USAID and IRMO have effective management reporting processes in place to ensure effective transparency of project cost, schedule, and performance.

On March 26, 2006, Bechtel reported to USAID that the estimated completion date for the project had slipped to July 31, 2007, and that estimated costs for the project had grown from \$50 million to \$98 million. We learned of this project status after our audit began, and consequently, we modified our objectives to determine the reasons for the project slippage and increased costs. Therefore, our review was adjusted to answer the following questions:

- Does USAID have effective processes in place for tracking and reporting the schedules of its Basrah Children's Hospital project?
- Does USAID have effective processes in place for tracking and reporting the cost of the Basrah Children's Hospital project to the Congress and to the Chief of Mission?
- Do USAID and IRMO have effective policies, procedures, and management controls in place to achieve expected project outcomes?

To determine the effectiveness of USAID's processes for tracking and reporting its projects we interviewed the Deputy Chief of Mission and personnel from IRMO, USAID, U.S. Army Corps of Engineers, and Bechtel National, Inc. to understand the roles and responsibilities of each party involved in the Basrah Children's Hospital project. We also obtained and reviewed all pertinent contract documents, and the Memorandum of Understanding between USAID and Project HOPE. Based on information obtained during our interviews and our document review we requested copies of all hospital project status reports prepared by the Corps of Engineers and Bechtel. We also requested and received all emails written by USAID personnel that pertained to the hospital project. Among the documents we obtained were weekly trend, activity, and schedule updates. These documents were analyzed and chronologically arranged to determine what information was available to USAID on the project and when it was available.

To determine USAID's processes for tracking and reporting costs, we met with the USAID-Iraq Mission Comptroller to obtain a description of USAID's accounting processes and information on how USAID calculates its' costs-to-complete and estimates-at-completion to meet the requirements of the Section 2207 and Project Assessment Reports. We also met with Bechtel officials to gain an understanding of the cost data provided to USAID by Bechtel. Finally, we discussed USAID's cost reporting with the IRMO budget officer to determine what IRMO received from USAID. We did not audit USAID's financial management or accounting systems.

To determine USAID's policies, procedures, and management controls we interviewed USAID contracting personnel including the administrative contracting officer, the cognizant technical officer, the Mission comptroller, and the Sector Manager. We also spoke IRMO officials about their oversight of the contract.

We performed this audit from April 12, 2006, through June 30, 2006, in accordance with generally accepted government auditing standards.

Use of Computer-processed Data. We performed no tests to determine the accuracy and reliability of the data we obtained from USAID.

Prior Coverage. Special Inspector General for Iraq Reconstruction Audit Report Number SIGIR-05-027, dated January 27, 2006, "Methodologies for Reporting Cost-to-Complete Estimates", concluded that (of among agencies examined in this report) USAID failed to estimate and report reliable and transparent cost-to-complete information for the IRRF projects we reviewed. USAID submitted quarterly Section 2207 Reports to Congress with errors that were significant enough to undermine users' confidence in the reporting.

Special Inspector General for Iraq Reconstruction Audit Report Number SIGIR-05-021, dated October 24, 2005, "Management of Iraq Relief and Reconstruction Fund Programs: Cost-to-Complete Estimate Reporting", concluded that USAID and IRMO have been required, since January 2004, to report cost-to-complete information for their IRRF projects in quarterly reports to Congress. However these (and other) agencies did not begin providing reasonably comprehensive cost-to-complete data to IRMO until recently.

Appendix B. Acronyms

| | |
|--------------|---|
| Project HOPE | Health Opportunities for People Everywhere |
| IRMO | Iraq Reconstruction Management Office |
| IRRF | Iraq Relief and Reconstruction Fund |
| SIGIR | Special Inspector General for Iraq Reconstruction |
| USAID | U.S. Agency for International Development |

Appendix C. Report Distribution

Department of State

Secretary of State

Senior Advisor to the Secretary and Coordinator for Iraq

U.S. Ambassador to Iraq

Director, Iraq Reconstruction Management Office

Mission Director-Iraq, U.S. Agency for International Development

Inspector General, Department of State

Department of Defense

Secretary of Defense

Deputy Secretary of Defense

Director, Defense Reconstruction Support Office

Under Secretary of Defense (Comptroller)/Chief Financial Officer

Deputy Chief Financial Officer

Deputy Comptroller (Program/Budget)

Inspector General, Department of Defense

Director, Defense Contract Audit Agency

Director, Defense Finance and Accounting Service

Director, Defense Contract Management Agency

Department of the Army

Assistant Secretary of the Army for Acquisition, Logistics, and Technology

Principal Deputy to the Assistant Secretary of the Army for Acquisition,
Logistics, and Technology

Deputy Assistant Secretary of the Army (Policy and Procurement)

Director, Project and Contracting Office

Commanding General, Joint Contracting Command-Iraq/Afghanistan

Assistant Secretary of the Army for Financial Management and Comptroller

Chief of Engineers and Commander, U.S. Army Corps of Engineers

Commanding General, Gulf Region Division

Auditor General of the Army

U.S. Central Command

Commanding General, Multi-National Force-Iraq

Commanding General, Multi-National Security Transition Command-Iraq

Commander, Joint Area Support Group-Central

Other Federal Government Organizations

Director, Office of Management and Budget

Comptroller General of the United States

Inspector General, Department of the Treasury

Inspector General, Department of Commerce

Inspector General, Department of Health and Human Services

Inspector General, U.S. Agency for International Development

President, Overseas Private Investment Corporation

President, U.S. Institute for Peace

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

U.S. Senate

Senate Committee on Appropriations

Subcommittee on Defense

Subcommittee on State, Foreign Operations and Related Programs

Senate Committee on Armed Services

Senate Committee on Foreign Relations

Subcommittee on International Operations and Terrorism

Subcommittee on Near Eastern and South Asian Affairs

Senate Committee on Homeland Security and Governmental Affairs

Subcommittee on Federal Financial Management, Government Information and International Security

Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

U.S. House of Representatives

House Committee on Appropriations

Subcommittee on Defense

Subcommittee on Foreign Operations, Export Financing and Related Programs

Subcommittee on Science, State, Justice and Commerce and Related Agencies

House Committee on Armed Services

House Committee on Government Reform

Subcommittee on Management, Finance and Accountability

Subcommittee on National Security, Emerging Threats and International Relations

House Committee on International Relations

Subcommittee on Middle East and Central Asia

Appendix D. Audit Team Members

This report was prepared and the audit work was conducted under the direction of Joseph T. McDermott, the Assistant Inspector General for Audit, Office of the Special Inspector General for Iraq Reconstruction. The staff members who contributed to the report include:

Mark L. Comfort

Glenn D. Furbish

John Morrell

James B. Pollard

Management Comments

U.S. Mission Iraq



Embassy of the United States of America
Baghdad, Iraq

July 26, 2006

INFORMATION MEMORANDUM
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TO: The Special Inspector General for Iraq Reconstruction – Stuart Bowen
FROM: Director, Iraq Reconstruction Management Office – Joseph A. Saloom 
SUBJECT: US Mission – Iraq Management Comment on “Review of the U.S. Agency for International Development’s Management of the Basrah Children’s Hospital Project” Report No. 06-026

On behalf of US Mission-Iraq, I am forwarding the comments below on the above referenced report.

The Ambassador has created and chairs a weekly meeting the Reconstruction Core Group, which includes all U.S. Mission agencies concerned with the full range of Iraq reconstruction issues. Discussion in this Reconstruction Core Group brought the issue of the problems associated with the Basrah Children’s Hospital to the attention of the Ambassador, who directed that action be taken to get the project back on track. In response to the Ambassador’s guidance, the members of this Core Group developed the plan to revise the Mission’s approach to completing this project that is described below in the section on recommendations.

This SIGIR report recommends providing IRMO with the authority to request and receive timely accurate and complete information on IRRF projects. To address this issue, the Ambassador has issued an instruction to all agencies that implement U.S. assistance under his authority to provide the Iraq Reconstruction Management Office with the accurate and complete information on such projects. SIGIR notes that providing IRMO with the authority to request and receive such information will “greatly improve the State Department’s oversight, and preclude surprises such as occurred on the Basrah Hospital project.” The U.S. Mission agrees with this conclusion and the Ambassador has granted IRMO this authority.

The SIGIR report also comments extensively on USAID’s accounting system and on its allocation system for indirect costs. The U.S. Mission agrees that accurate monitoring of projects requires allocating indirect costs in systematic way that reflects accurately the true indirect costs attributable to specific activities and projects, such as Basrah Children’s Hospital. The Ambassador has directed the USAID Director work with the IRMO Director to establish reporting systems that assure that information is made available that reflects the most accurate possible direct and indirect cost allocations by projects and programs.

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- 2 -

Following are U.S. Mission Responses to the specific recommendations on Page 18 of the SIGIR Report

We recommend that the U.S. Ambassador to Iraq take the following actions:

1. Direct USAID Mission Director-Iraq to:

- a. Issue a "stop work" order to Bechtel and its subcontractors until there are sufficient plans, resources, and processes in place to ensure a successful project.

Mission Response: US Mission-Iraq concurs and USAID has told Bechtel to stop construction and to move to a "preserve and protect" mode at the construction site until project management can be transferred to the U.S Army Corps of Engineers, Gulf Regional Division. IRMO and USAID are now working with the Department of State and USAID Washington to put in place sufficient plans, resources, and processes to ensure a successful project. This involves reprogramming funds subject to Congressional notification requirements and seeking other sources of funding.

- b. Report on the total project, including Project HOPE's activities in its Section 2207 Report.

Mission Response: US Mission-Iraq concurs and reported the total IRRF project in the July 2006 Section 2207 Report in accordance with Public Law 108-106. Project HOPE contribution is not included in this total as Project HOPE does not fall within the purview of the requirements of the Section 2207. While not legally required, we plan to add information in subsequent reports on specific Project Hope contributions as they are received.

- c. Provide the IRMO Director with timely, accurate, and complete information as deemed necessary to ensure the project has independent oversight.

Mission Response: I concur and have directed all agencies to provide IRMO timely, accurate and complete information deemed necessary for independent project oversight. In addition, IRMO, USAID, and GRD/PCO have been participating in cost-to-complete exercises each month to detail project costs and performance and provide timely, accurate and complete information on all reconstruction projects.

2. Direct the IRMO Director and the USAID Mission Director-Iraq to:

- a. Promptly report on the answers to the Deputy Chief of Mission's questions provided on June 6, 2006.

[The Deputy Chief of Missions specifically requested (1) the true cost and schedule to complete the project (the DCM defined completion as a fully functioning hospital); (2) what would be accomplished with the \$50 million that was allocated when the costs against this \$50 million would be incurred; and (3) what options are available to complete the project to complete the project to include options for funding, contracting, project management, and oversight.]

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– 3 –

Mission Response: US Mission-Iraq concurs and has answered the Deputy Chief of Mission questions through discussions.

- b. Consider alternative forms of contracting and project management to complete the project.

Mission Response: US Mission-Iraq concurs. US Mission-Iraq has directed the transfer of program and project management for the Basrah Children's Hospital from USAID to GRD.

- c. Develop a management structure to ensure the success of this project.

Mission Response: US Mission-Iraq concurs with both of the above. GRD has the necessary management structure to properly manage large construction projects and will ensure appropriate subordinate management controls to include routine cost-to-complete reviews with IRMO, the establishment of a GRD-led special project office in Basrah with USAID and Project HOPE representatives, a GRD-provided hospital and equipment integrator to ensure synchronization of effort, and program management additions at GRD headquarters to ensure adequate controls during execution. IRMO will continue to oversee execution of this vital project, as well as the other remaining 1,000 projects, through periodic reviews and weekly reports such as the Reconstruction Core Group, Sector Reviews, Cost-to-Complete, and Program Review Boards.

An IRMO-USAID-GRD/PCO Project team has been established:

- Memorandum of Understanding between USAID and GRD/PCO is signed.
- Team will report program status to IRMO at weekly update meetings.

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